Appeal No. 21,165

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Appellants,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION, etc., *et al.*,
Appellees.

BRIEF OF APPELLEES:

A.M.R, Inc.; Alamo Savings and Loan Association; Altadena Federal Savings and Loan Association; American Federal Savings and Loan Association; Broadway Equities, Inc.; Burroughs Detroit Employees Credit Union; Charter Savings and Loan Association; Coachella Valley Savings and Loan Association; Columbia Savings and Loan Association; Community Federal Savings and Loan Association; Corning Glass Works Employees Federal Credit Union; Custer County Federal Savings and Loan Association; Dearborn Schools Credit Union; Designing Engineers Credit Union; Detroit Teachers Credit Union; First Federal Savings and Loan Association of Arkansas City; First Federal Savings and Loan Association of Manatee County; First State Bank of Bangs; First Western Savings and Loan Association; Flagler Federal Savings and Loan Association; Flint Teachers Credit Union; Friendship Federal Savings and Loan Association; Glendale Federal Savings and Loan Association; Hawthorne Savings and Loan Association; Home Federal Savings and Loan Association of East Rochester; Home Federal Savings and Loan Association of San Diego; Home Savings Association of Chanute, Kansas; International Union, United Automobile, Aerospace and Agricultural Implement Workers of America—UAW; Jervis Corporation Employees Credit Union; Kawneer Employees Credit Union; Lawrence-Cedarhurst Federal Savings and Loan Association; Library Credit Union; Marina Federal Savings and Loan Association; Mile High Savings and Loan Association; Monarch Savings and Loan Association; Nevada Savings and Loan Association; North American Investment Fund NV; Redwood Empire Savings and Loan Association; Rock Falls Savings and Loan Association; Shaker Savings Association; South Ferry Building Company; Union Federal Savings and Loan Association; Voice of Music Employees Credit Union; Westdale Savings and Loan Association; Western Savings and Loan Association.

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Appeal No. 21,165

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AMERICAN TELEPHONE AND TELEGRAPH COMPANY, SECURITY SAVINGS AND LOAN ASSOCIATION AND VICTORIA SAVINGS AND LOAN ASSOCIATION,
Appellants,

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Statement of Jurisdiction.

For its Statement of Jurisdiction, Appellees herein adopt the Statement of Jurisdiction contained in the Appellant's Opening Brief of the American Telephone and Telegraph Company, pages 2-3.

Statement of the Case.

This is one of a number of interrelated appeals now pending before this Court involving the distribution of the assets of the defunct San Francisco National Bank (hereinafter referred to as "SFNB").[1]

This brief is filed on behalf of certain appellees, all of whom were depositors in SFNB when its doors were closed on January 22, 1965 (R. [21165] 4) and who are thus claimants against the estate of SFNB. In the aggregate the claims of these appellees represent in dollar amount a majority of the claims against the estate—excluding the claims of the Federal Deposit Insurance Corp. (hereinafter referred to as "FDIC") and

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[1]These appeals, in order of the commencement of the actions in the Court below, are:

(1) The various appeals in No. 21237, which involve the legal validity of counterclaims filed by Appellees herein and other depositors in SFNB against FDIC asking that, on equitable principles, the claims of the FDIC against SFNB be satisfied after those of these depositors and that these depositors' deposits be adjudged to be held in constructive trusts.

(2) Appeals Nos. 21231, 21257, 21181 and 21191, which involve substantially the same questions as in (1) above, raised in independent actions filed by some Majority Depositors against both the FDIC and the District Bank.

(3) The instant appeal wherein the Telephone Company sued 88 other depositors in SFNB claiming individual priority over such depositors, and Security and Victoria filed counterclaims asserting individual priorities over other depositors.

(4) Appeals Nos. 21258-D and 21258-F, wherein some of the Appellees sought to intervene in the receivership proceedings of SFNB and were denied the right to do so on the ground that such proceedings were not judicial.

the Federal Reserve Bank of San Francisco (hereinafter referred to as "the District Bank") [Appendix A]. These appellees are herein referred to as "Majority Depositors".

Appellant American Telephone and Telegraph Company (hereinafter referred to as "the Telephone Company") was plaintiff below. Its complaint asserted two main claims:

First, that the Telephone Company is entitled to priority over the Majority Depositors (and other depositor defendants) in the distribution of the assets of SFNB (R. [21165] 9-10). This claim was grounded on allegations that the depositor defendants, as part of link-financing or money-brokerage transactions, received some benefit other than interest for making their deposits (R. [21165] 4-5). The Telephone Company alleges that each of the more than 80 defendants named by it received from SFNB, "as compensation for *making* or *renewing* . . . [their] deposits [it is not alleged that such were received for the *maintenance* of their deposits], in addition to interest at legal rates . . . certain benefits, bounties or gratuities prohibited by law," which "benefits, bounties or gratuities" the complaint proceeds thereafter to refer to as "bounties" (R. [21165] 4, line 72 to 5, line 2, emphasis added).

It alleges that it did not know that such benefits had been received *from SFNB* "or those acting on its behalf", and that *SFNB* had concealed the payment of such benefits from the Telephone Company. There is no allegation of any *facts* that would cause the payment of any such benefits to be illegal, or of any knowledge on the part of any defendants of facts that would cause any such payments to be illegal, or of any

duty on the part of SFNB to advise the Telephone Company that it or someone in its behalf had paid such alleged benefits (R. [21165] 5, line 29 to 6, line 7).

The allegations depart from a recitation of payments to depositors for the *making* or *renewal* (not *maintenance*) of deposits in typical link-financing and money-brokerage transactions (discussed, *infra*) in the statement that such were "prohibited by law", and from link-financing, though not necessarily from money-brokerage, in that allegedly such benefits were received "from the Bank". At one place in the complaint, however, this is qualified to state "from Bank, *or those acting on its behalf",* which presumably would include payments by SNFB borrowers for the placement of deposits in a typical link-financing transaction (R. [21165] 4, line 27 to 5, line 2; 5, line 29 to 6, line 1, emphasis added).

The complaint claims, secondly, that in any case the Telephone Company's deposit was the subject of a constructive trust because it was accepted—or its renewal was accepted—by SFNB when it was insolvent and known by its officers and directors to be so. On this basis, the Telephone Company asserted a priority over any other depositor who could not make the same showing (R. [21165] 7-8).

The complaint also claimed priority over the FDIC to the extent that it was subrogated to the claims of insured depositors who, but for the payment of Federal Deposit Insurance, would themselves have been subordinated on either of these theories (R. [21165] 9).

Security Savings and Loan Association (hereinafter referred to as "Security") and Victoria Savings and

Loan Association (hereinafter referred to as "Victoria") crossclaimed against the Majority Depositors and the FDIC, adopting in the main the Telephone Company's contentions (R. [21165] 15, 19).[2] This appeal is taken from the dismissal of the Telephone Company's complaint and the crossclaims (R. [21165] 159, 456, 457).

Though the Majority Depositors appear here as appellees, they are in accord with the appellants on a number of important points. In summary, it is their contention that the first of appellants' two claims is unfounded in law. The receipt by the depositor of a special benefit, other than interest, in connection with his deposit, whether through a link-financing or a money-brokerage transaction—even if proved—does not mean that his claim against the insolvent bank should be subordinated to those of depositors who did not receive such benefits.

The second claim, however, we think is sound. A deposit accepted or renewed when a bank is insolvent, and known by its officers to be so, is impressed with a constructive trust. This is certainly so where the making or renewal of the deposit was induced by affirmative representations as to the bank's solvency, known to be false by the bank's officers who made them, and relied on by the depositor. Holders of such deposits are entitled to priority over other claimants not similarly situated.

More fundamentally, the Majority Depositors here are in agreement with the Telephone Company that

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[2]Victoria's other contention is that because of the culpable conduct of the FDIC with respect to SFNB, Victoria is entitled to a preference over the FDIC in the distribution of the assets of SFNB (R. [21165] 30-31).

creditors of an insolvent bank have the right to a determination, in a judicial proceeding to which they may be parties, of the relative priorities of the claims against the estate of the bank. This is the meaning of the statutory command for a "ratable" distribution contained in 12 U.S.C. §194.

The effect, if not the intent, of the rulings in this and the related cases below has been to deprive the creditors of SFNB of any forum in which to try the issues of the relative priority of their claims, both as between the various private claimants and as between groups of private claimants and the FDIC. All the private creditors, on whatever side they appear in this case, are at one in asking this Court to redress this fundamental denial of the right to be heard.

Statement of Facts.

SFNB was chartered on May 1, 1961 and began operations on June 1, 1962 (Hearings, 69).[3] Outwardly, it appeared successful and prosperous. Nevertheless, from the very beginning of its existence gross irregularities and violations of law were present in the bank's operations (Hearings, 69-72, 483).

Appellant Victoria in this appeal, and Majority Depositors in related appeals, have alleged that by December 31, 1963, knowing of the insolvency of SFNB,

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[3]This reference is to the Transcript of Hearings on Investigation into Federally-Insured Banks before the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations, 89th Congress, First Session (1965).

the FDIC, the District Bank and the Comptroller of the Currency as well as SFNB's directors, embarked upon a common course of conduct to keep SFNB open (R. [21165] 30-31; R. [21231] 3-5; R. [21257] 3-6; R. [21181] 2-4; R. [21191] 2-5). In pursuit of this course of conduct, these agencies sponsored the solicitation of deposits from Majority Depositors and others on the basis of falsified financial statements and misrepresentations. (R. [21165] 32; e.g., R. [21237]97).[4]

Late in 1964, the volume of deposits, even with this solicitation, became inadequate to keep SFNB open. Every banking day, from August 28, 1964, until January 22, 1965, the date on which SFNB was closed,

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[4]Direct participation in the solicitation of deposits for an insolvent bank through fraudulent financial statements and other misrepresentations is a step beyond any announced policy of the FDIC. Nevertheless, the stated policy of the FDIC shows something less than a sharpened conscience. In response to a Congressional questionnaire, with regard to disclosing to innocent members of the public the risk which may be entailed in depositing funds in a given bank, the FDIC stated:

> "The nature of banking and of the public interest in banks shape the procedural aspects of bank supervision in forms different from those encountered in other branches of administrative regulation. By reason of the fact that few banks operating at a profit can, upon demand, pay off its (sic) depositors in cash, there has been traditionally a policy of withholding from the public all information which either with or without justification, might provoke a depositors' run on a bank. Accordingly, depositors are not expected to exercise an informed individual judgment concerning the soundness of the bank in which they have deposited their funds, but must rely upon the vigilance and competence of the supervising authorities. As a corollary, the exercise of supervisory powers over banks has traditionally been attended by a secrecy antithetical to the publicity which marks most regulatory activities." Survey and Study of Administrative Organization, U.S. House of Representatives Committee on Government Operations, Part IIB (FDIC response to questionnaire) page 1401 (U.S. Government Printing Office 1957, No. 95899).

the District Bank, in close cooperation with the Comptroller of the Currency and the FDIC, made new loans to SFNB of funds necessary to keep SFNB's doors open, taking out $14 million of assets to secure a final $9.26 million of advances (Hearings, 243, 248, 281).[5]

The last such loan to SFNB was not made until January 22, 1965, the very last day of SFNB's life. This loan, in the amount of $1,300,000.00, enabled SFNB to make payment on a certificate of deposit to Lytton Savings and Loan Association in the amount of $1,500,000.00 plus interest. (Hearings, 251, 307-312). By exhausting the assets of SFNB that the District Bank would accept as collateral, the advance plus the Lytton withdrawal it made possible forced the seizure of SFNB that night (Hearings, 308-309).

In addition, a bank examiner's letter, recommending criminal proceedings, prepared in June, 1964, was held up seven months, until after SFNB was finally seized (Hearing, 251, 307).[5]

During all of 1964 and the first three weeks of 1965, the Majority Depositors and others, beguiled by and relying upon the false image of SFNB thus projected by misleading financial statements, misrepresentations, and the District Bank actions, either made new deposits or renewed or maintained existing deposits in SFNB when SFNB was, and knew itself to be, hopelessly insolvent (R. [21237] 59, 93, 103, 131, 142,

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[5]The District Bank was scrupulous with regard to the care that it exercised in selecting only the very best assets of SFNB grossly in excess of its advances as security for its loans and constantly went back to the portfolio to substitute new collateral for any that had proved substandard and to take out additional selected collateral, during all of which time the Majority Depositors have alleged SFNB was "hopelessly insolvent", which the District Bank knew. (R. [21231] 5).

153, 161, 172, 184, 196, 207, 217, 228, 229, 239, 249, 257, 269, 282, 289, 297, 309, 320, 327, 345, 357, 378-h). The agencies' actual appraisal of the situation was well expressed by the Comptroller of the Currency, by law one of the FDIC's three directors, who stated to the Senate Committee that by May of 1964 SFNB "was so murked down in just plain rot and corruption that there was *no hope.*" (Hearing, 108, et seq., emphasis supplied).

This course of conduct of the agencies prolonged SFNB's life while the agencies sought another bank willing to absorb SFNB by merger (Hearings, 100). A consequence of the prolonged life was to permit certain depositors, who were more fortunate or better informed or had better liaison with the agencies than either the appellants herein or the majority depositors, to withdraw their funds *in toto* instead of being compelled to share, *pro rata,* with the remaining depositors (Hearing, 251, 307).[6]

No creditor in any of these appeals seeks money damages at law for the harm which the FDIC has caused. They ask only that the Court below, as a court of equity to determine ratable distribution, take into consideration the position in equity of the FDIC as a corporate creditor claimant seeking to share ratably with the creditors it induced to place their moneys in

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[6]Another consequence may have been to effect a substantial reduction in the FDIC's insurance of accounts liability with respect to SFNB. It is reasonable to suspect that during the last year or so of its existence the deposit situation of SFNB underwent a dramatic change. A large number of small local accounts were withdrawn to be replaced by a smaller number of large accounts. Since the FDIC's maximum liability under its insurance of accounts was, at that time, $10,000 per account, any reduction in the *number* of accounts was obviously to its advantage.

the insolvent SFNB (See, e.g., R [21237] 269, et seq.) (R. [21231] 1 et seq; R. [21258] 216 et seq.).

Statement of Issues.

Appellants state that for purposes of ruling upon the propriety of the District Court's action in dismissing their complaints and cross claims, all of the allegations in their pleadings must be assumed to be true (Tel. Co. Open. Br., P. 2; Victoria Open Br., P. 5). Appellee majority depositors concur.

But appellants understate their position. The issue before this Court is not only whether the allegations of appellants contained in their present complaints and cross claims would, if true, entitle them to the priorities which they seek. Rather, it is whether there is any reasonable prospect that the appellants could, if permitted to do so, amend to allege facts upon which any relief could be granted.

The position of the majority depositors is that the Court below erred in dismissing appellants' pleadings without leave to amend, and that appellants, as well as appellee Majority Depositors, have a right to an adjudication of relative priorities to the remaining assets of SFNB's defunct estate, including priorities *vis-a-vis* the FDIC as a corporate claimant against those assets. The majority depositors cannot in conscience, and therefore do not, contend that any creditor be refused a hearing on a contention of priority in the determination, by a court of equity, of ratability in distribution of the remaining assets of SFNB.

ARGUMENT.

I.

APPELLANTS SHOULD BE PERMITTED TO AMEND TO STATE CLAIMS FOR IMPOSITION OF CONSTRUCTIVE TRUSTS ON THEIR DEPOSITS AND TO SUBORDINATE FDIC'S CLAIMS.

The Telephone Company's claim is for $500,000 in deposits which matured and were renewed on December 28, 1964.[7] Victoria's claim is for a $360,000.00 cashier's check issued to it on January 16, 1965, and a $150,000.00 Certificate of Deposit issued the same day, both of which were issued to Victoria in consideration of five $100,000 certificates of deposit which matured on January 16, 1965 (R. [21165]5, 23-24).

The Telephone Company argues that the condition of SFNB on December 28, when its deposit was renewed, was such that the renewal was a fraud, giving rise to a constructive trust. (Tel. Co. Op. Br., p. 8), Victoria alleges that the bank was insolvent and knew itself to be such on January 16, 1965, when the cashier's check and $150,000 Certificate of Deposit were issued to Victoria. (R. [21165] 24).[8]

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[7]The Telephone Company does not state when its deposit in SFNB was made.

[8]The position of Victoria is slightly different from that of the Telephone Company and Security in that, on January 16, 1965, it withdrew the largest portion of its deposits. R. 24. Unfortunately for it, however, unlike Lytton Savings and Loan Association whose deposit matured six days later than Victoria's, it was paid not by telegraphic transfer of federal credits by the District Bank, but by SFNB's cashier's check through the mails. Before the check could be cashed, the SFNB was declared insolvent (Victoria Open. Br., p. 5).

If the condition of SFNB on December 28, 1964, was such, as alleged by the Telephone Company, that it could not accept or renew deposits, a payment by SFNB of the deposit to the Telephone Company would have constituted an unlawful preference (See 12 U.S.C. § 91). Victoria, too, in alleging that it received the cashier's check during SFNB's insolvency, necessarily admits that it was not entitled to withdraw that money on January 16, 1965. Nevertheless Victoria and the other appellants should be allowed to amend to state facts justifying the imposition of constructive trusts to give them priority over all creditors of SFNB not also able to establish such priority. If able so to amend and then to prove that their deposits have the status of special deposits, Victoria, and the other appellants, could achieve priority over those, not excluding the FDIC, who cannot on equitable principles establish their respective claims of special deposits.

In addition, totally apart from its right to prove that its own deposits are special deposits and therefore should be paid before other claimants who cannot establish such status, Victoria has stated or should be given an opportunity to state a case for subordinating the FDIC's claims on equitable grounds of the FDIC's culpable involvement in Victoria's loss.

II.

APPELLANTS HAVE NOT ALLEGED FACTS WHICH CHARGE THE MAJORITY DEPOSITORS WITH INEQUITABLE CONDUCT SUCH AS IS CONTEMPLATED BY 12 USC § 194 FOR SUBORDINATION OF MAJORITY DEPOSITORS' CLAIMS. NEVERTHELESS, APPELLANTS SHOULD BE GIVEN THE OPPORTUNITY TO AMEND THEIR PLEADINGS TO DO SO.

A. Appellants Should Be Permitted to Amend.

While the Telephone Company's complaint is divided into six counts, the factual allegations grounding its claim of preference over the majority depositors is set forth in the first Count: the Telephone Company charges that "as a compensation for making and renewing . . . [their] deposits, and in addition to interest at legal rates, each of these defendants . . . received directly or indirectly from Bank certain *benefits, bounties or gratuities* prohibited by law (*hereinafter collectively called "bounties"*) (R. [21165] p. 4, line 31 to p. 5, line 2; emphasis supplied); that the Telephone Company's "sole compensation for [its] deposit and for its renewals was the payment of interest at legal rates . . ." (*id.*, p. 5, lines 25-27); that when it "renewed its deposit on December 28, 1964, it was unaware that . . . [the defendants] had directly or indirectly received bounties from Bank, or those acting on its behalf, as consideration for making or renewing their deposits . . ." (*id.*, p. 5, line 29 to p. 6, line 2); that "Bank concealed the payment of said bounties . . .

from the Telephone Company (*id.*, p. 6, lines 6-7); that "[h]ad plaintiff known of the payment of the aforesaid bounties, it would not have renewed its certificate of deposit on December 28, 1964." *Id.*, p. 6, lines 10-12.*

The remaining counts add little to the substance of Count I: the defendants "acted in a manner contrary to public policy and, in effect, converted to their own use monies of innocent depositors through the medium of improper and illegal transaction with Bank." (*Id.*, p. 8, lines 26-29); "the payment of bounties contributed to the insolvency of the Bank and to plaintiff's loss . . . the payment of bounties . . . were contrary to public policy. . . ." (*id.*, p. 9, line 29, to p. 10, line 2).

The Telephone Company alleges no facts which would show that the receipt of so-called "bounties"—to use the Telephone Company's colorful but prejudicial terminology—was illegal. There is nothing wrong, *per se,* in receiving a "benefit, bounty or gratuity." Yet this is the gravamen of the Telephone Company's complaint.

Let us assume, *arguendo,* that the Telephone Company could amend to allege the payment of cash consideration to a church, or to a union or corporate defendant, for *making* a deposit, and that the total of the amount paid for the making of the deposit, plus the amount that *would have been paid* as interest had SFNB not been closed before the payment of any interest in the deposit, would have exceeded the percentage figure permitted to be paid *by the bank* as interest

*Presumably, had *any* depositor known of the *volume* of SFNB brokered and link financing deposits it would not have made its deposit.

on the particular category of deposit, the complaint should be dismissed unless it also contains allegations of special circumstances known to the depositor that would make the transaction wrongful.

The payment of consideration by a borrower from a bank to a depositor in link financing transactions is an established banking practice. Perhaps in its oldest form, link financing grew out of the requirement of a lending bank that its borrower maintain a certain part of the sum advanced as a "compensating balance."[9] A certificate of deposit, possibly non-interest bearing, might be issued by the bank to its borrower for this "compensating balance." The borrower could sell the certificate at a discount to a corporate treasurer or another buyer whose short-term requirements matched the term of the certificate. The corporate treasurer had the advantage of a bank deposit, and the borrower had the use of a greater part of his total borrowings. This practice antedated both Regulation Q and the Federal Deposit Insurance Act.[10]

After World War II, brokers became increasingly active in this field. The certificates of deposit issued by banks for this purpose were more likely to be interest-bearing. Corporations which had relatively pre-

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[9]See, for example, Robert G. Rodkey, *The Banking Process,* New York: The MacMillan Company, 1928, Ap. 180-181; Henry Thornton, *Substances of Two Speeches of Henry Thornton, Esq. on the Bullion Report,* 1811, p. 20, cited in Jacob Viner, *Studies in the Theory of International Trade,* 1937, p. 152; and Howard Whipple, "The Average Balance Theory: Is it Justified?" *American Banker's Association Journal,* May 1931.

[10]Richard Fieldhouse, *Certificates of Deposit* (Boston: Banker's Publishing Company 1962), p. 29. Richard Fieldhouse is a member of the staff of the Federal Reserve Bank of New York.

dictable periods of cash surplus before tax or dividend dates regularly purchased such certificates through the money brokers.[11] Savings and loan associations, which were permitted to include the amount of such certificates as "cash" for purposes of minimum liquidity requirements, constituted a large market.[12]

The purchase of certificates of deposit by savings and loan associations has been closely regulated by the Federal Home Loan Bank Board. An important consideration for a savings and loan association in determining whether or not to purchase certificates is whether certificates of deposit may be considered for purposes of satisfying the liquidity requirements imposed by the Federal Home Loan Bank Board. (12 C.F.R. 523.12(b).[13] For an excellent summary of the history of the regulations governing the purchase of certificates of deposit by savings and loan associations, see U.S. Savings & Loan League Federal Guide, pages 8172-8173. During the late fifties, the Board promulgated a regulation providing that certificates of deposit could not be considered as "cash" for purposes of savings and loan associations' liquidity requirements unless the association itself had made the deposit for which the certificate was issued. (Rules and Regulations of the Federal Home Loan Bank Board, 555.10 and 570.1, now rescinded).

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[11]See Jack M. Gutentag and Richard G. Davis, "Compensating Balances", Federal Reserve Bank of New York, Monthly Review XLII (December, 1961), pp. 205-210. By August, 1966, C/D money reached its peak of $18.5 Billion. N.Y. Times, Oct. 23, 1966, Sec. III, p. 1, col. 3.

[12]Lawrence T. Crumb, *Time Deposits in Present Day Commercial Banking*, University of Florida Press, Gainsville, Florida (1963), p. 31. 12 C.F.R. 556.1.

[13]The term "cash" shall mean cash on hand, and cash on deposit in banks, including Federal Home Loan Banks, which is not pledged as security for indebtedness.

It is reasonable to suspect that the imposition of the requirement that the association itself make the deposit for which the certificate is issued resulted in a greater role for the money broker, who would arrange for one who borrowed through him to compensate the depositor for making the deposit in the bank, and for identifying the deposit to the bank which would then give credit to the borrower for it as a compensating balance. Thereafter, in 1964, the use of certificates of deposit for purposes of savings and loan associations' liquidity requirements was further circumscribed. (12 C.F.R. 530.1)

The interest, if any, paid by a member bank on the certificate of deposit could not lawfully exceed the Regulation Q maximum (Regulations of the Federal Reserve System, 12 C.F.R. 217.3). No direct controls applied to the amounts paid by the borrower from any bank for the making of the deposit, either to the broker or the depositor. Repeated excessive payments or too great a total of such deposits might well—and in case of SFNB did—call for inquiry into the bank's lending and liquidity policies. Normally, however, only the federal agencies and the national bank itself, not any single depositor, would know that such a condition existed unless it was reflected on public financial statements.

A further development, specifically ruled to be lawful by the Comptroller of the Currency, was the employment of money brokers on a percentage commission by banks themselves to obtain time deposits (represented by certificates of deposit) rather than as compensating balances for specific loans. (National Banking Review, September 1964, p. 99). Among savings and loan associations there is a regulation limiting the

volume of savings accounts in such institutions so obtained through money brokers to five per cent (5%) of all withdrawable savings in an insured association. 12 C.F.R. 563.25(c). This is accompanied by severe limitations on the amount the association or a money broker might pay to the saver for *placing* his savings in the institution (as distinguished from interest or dividends on the savings). 12 C.F.R. 563.24. But these express regulatory or statutory controls apply to deposits in savings and loan associations. No comparable regulations applied to time deposits in commercial banks during the period here relevant.

Even more significant is the action of the FDIC. On February 3, 1965, twelve days after FDIC had closed SFNB, FDIC filed a complaint for declaratory relief against 87 holders of certificates of deposit in SFNB. The complaint asked for judgment that the FDIC was "not obligated to pay for, to or on behalf of, defendants, or any of them, any sum or sums or insurance pursuant to provisions of Federal Deposit Insurance Act". (R. [21237] 11, lines 6-8). This prayer was based upon the alleged receipt by the defendants of fees for placing certificates of deposit in SFNB, and was brought under the Federal Deposit Insurance Act.[14] Thereafter, however, the FDIC abandoned its complaint and paid off under its insurance of accounts obligation. (e.g. R. [21258] 73, 97). Such payment would necessarily have required a determination that the deposits were "in the normal course of business" (28 U.S.C. Section 1813(1)).

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[14]". . . in any case where the corporation [FDIC] is not satisfied as to the validity of the claim for an insured deposit it may require the final determination of a Court of competent jurisdiction before paying such claim". (12 U.S.C. 1821(f).)

Finally the legality of a depositor's accepting fees from a borrower in connection with a link financing transaction has been upheld by the court. *Farm Mortgage Trust Co. v. Wilson,* 110 Kan. 786, 205 Pac. 610, 612-613 (1922); *Farmers and Merchants Nat. Bank v. Foster,* 112 Kan. 141, 210 Pac. 490, 491 (1922).

The Telephone Company apparently sought to avoid this principle by alleging that the benefit which, *arguendo,* we are assuming was a fee for the placement of the deposit, in fact came from the Bank, and not from a third party. We know of no case which has held that it is wrongful for a depositor to accept such a benefit. Indeed, it has been expressly held that a depositor commits no wrong in accepting a fee which he believes comes from a borrower in connection with a link financing transaction, even though in reality the fee comes from the bank. *Pitts v. People Bank* (1924) 137 Miss. 240, 102 South. 279, 281:

> "It seems to be established on reason and authority that a depositor will not be denied protection under the Guaranty Law because the depositor was solicited by a third party, not an agent of the bank, and who, to advance his own interest, paid the depositor a bonus to procure the making of a deposit, and it seems clear that such would be the case where the bonus was actually paid out of the funds of the bank, *if the depositor had no such knowledge or agreement with the bank and no knowledge of the fact that the bank was paying the bonus.*" (102 South. 281; emphasis added).

The Telephone Company's complaint does not allege the necessary knowledge or belief by the defendant depositors.

While the appellants have not pleaded facts entitling them to a preference *vis-a-vis* the Majority Depositors, the Majority Depositors do not believe that this Court, with only pleadings before it, should find that there is no reasonable possibility that the appellants could amend to state a cause of action. The Majority Depositors are confident that they are innocent victims of gross wrongdoing in connection with SFNB and that the appellants will not be able to establish a claim for preference over them. Nevertheless, the Majority Depositors believe that the law entitles appellants to an additional opportunity to plead facts which, if true, would entitle them to such a preference.

B. There Is Original Jurisdiction in the Federal District Court.

Here, the cause of action which the appellants are attempting to assert obviously arises under Federal Law. Under 28 U.S.C. § 1331, "the district courts . . . have original jurisdiction of all civil actions arising under the . . . laws . . . of the United States." The appellants are asserting that they are entitled to a priority in the distribution of the assets of an insolvent national bank. The manner in which those assets are to be distributed is, as indicated in Section IA, *supra,* prescribed by Federal statute, 12 U.S.C. § 194. It is a matter of Federal Law for decision by Federal courts. *American Surety Co. v. Bethlehem Nat. Bank,* 314 U.S. 314 (1941).

> "The moment a national bank went into the hands of a receiver, *the Federal Law became the law of the distribution of its assets . . .*" (*Chicago First National Bank v. Seldon* (Ill. 1903) 121 F. Supp. 562, 565) (emphasis added).

> *"The distribution of the assets of an insolvent bank is controlled by the law enacted by Congress which requires a ratable distribution thereof."* (*Bryant v. Lynn County Or.* (D.C. Or. 1928) 27 F. Supp. 562, 565) (emphasis added).

The order dismissing the claims of the appellants for a lack of federal jurisdiction was clearly erroneous and should be reversed.

III.

THE CLAIM OF VICTORIA FOR PRIORITY OVER THE FDIC BASED ON THAT AGENCY'S IMPROPER COURSE OF CONDUCT IN CONNECTION WITH THE EVENTS LEADING TO SFNB'S FAILURE SHOULD BE ENTERTAINED IN ACCORDANCE WITH THE STATUTORY SCHEME FOR RATABLE DISTRIBUTION.

In its verified cross-complaint, Victoria alleges that "during 1964 cognizant agencies and instrumentalities of the Federal Government, including defendant Federal Deposit Insurance Corporation (hereinafter 'FDIC') came to know that Bank [SFNB] was insolvent or in imminent danger of insolvency . . ." These agencies thereupon "engaged in a course of conduct with bank management and with each other . . . in an effort to keep Bank open and to avoid disclosure of its true condition to the public . . . Such course of conduct was undertaken in order to induce defendant Victoria and others to make and/or maintain their . . . deposits in Bank . . . The course of conduct was intended to inure to the benefit of defendant FDIC, and specifically to permit the defendant FDIC to delay, reduce and conceivably to avoid altogether any liabilities on its in-

surance obligations which mature whenever an insured bank is closed on account of inability to meet demands of depositors." (R. [21165] 30-31). The cross-claim then goes on to describe a number of specific acts of misconduct by the FDIC and the agencies with whom it conspired.

Victoria's allegations against the FDIC are similar to the allegations of Majority Depositors in the related appeals now pending before this Court. Since the issues related to the statement of a cause of action are treated in considerable depth in these related appeals, appellants limit themselves here to a very abbreviated statement of legal bases for Victoria's claim. It is our view that decision on this question should be reserved until the companion appeals are disposed of.

The Majority Depositors are at a disadvantage in demonstrating what could have been alleged, if amendment had been allowed to Victoria in this case or to the Majority Depositors in the cases in the related appeals. The factual showing of the Majority Depositors in the Court below in Appeal Nos. 21231, 21257, 21181, 21191, and 21237-A was stricken from the records on appeal by the District Court, and this Court denied the motion of Majority Depositors to restore those portions of the records below to the records on appeal.[15]

The basic legal points, however, may be simply stated.

Federal law prescribes that the assets of an insolvent national bank are to be distributed ratably:

> "From time to time, after full provision has been made for refunding to the United States any

[15](Order on Motion to Restore Stricken Portion of record on appeal in Appeal Nos. 21237-A, 21231, 21251, 21181 and 21191, dated filed Nov. 16, 1966).

> deficiency in redeeming the notes of such association, *the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver* on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisfiction . . ." (12 U.S.C. § 194) (emphasis added).

What is a "ratable" distribution? It is "a 'just and equal' distribution of an insolvent bank's assets through the operation of familiar equitable doctrines evolved by the courts." (*American Surety Company of New York v. Bethlehem National Bank, supra.* See also *Jenkins v. National Surety Co.,* 277 U.S. 258, 267 (1928); *Davis v. Elmira Savings Bank,* 161 U.S. 275, 284 (1896)).

Victoria has charged that the FDIC induced it by an improper and misleading course of conduct to deposit money in an insolvent bank. The effect of this fraud was to reduce the FDIC's insurance of accounts liability. In other words, the FDIC used Victoria as an unwitting "reinsurer" of SFNB's failure.

"The operation of the familiar equitable doctrines" requires that the FDIC should not be permitted to enjoy the fruits of improper conduct by getting a greater net realization from SFNB's assets at the expense of its victims than it would have received had it not been involved in such improper conduct.

IV.

IT WOULD BE PREMATURE FOR THIS COURT TO ATTEMPT TO FORMULATE GUIDELINES FOR THE GUIDANCE OF THE DISTRICT COURT AT THIS STAGE OF THE PROCEEDINGS.

It may be that, in remanding this matter to the District Court, this Court will wish to formulate guidelines for use by the District Court in determining the priorities of the various claims to the assets of SFNB, both in this case and in the related appeals. While the prospect of formulating such guidelines has a certain superficial appeal, the Majority Depositors respectfully submit that such guidelines are premature at the present stage of the proceedings.

In order for this Court to lay down guidelines which would be meaningful and helpful to the District Court, it must know, or be able to anticipate with reasonable accuracy, the facts bearing upon priority which the various claimants to the assets of SFNB will attempt to prove at trial. The Majority Depositors respectfully submit that this Court has not been presented with the necessary factual background.

First of all, the pleadings are imprecise. For example, the appellants in this case charge the Majority Depositors with receiving "benefits, bounties or gratuities." This comprehends an extremely broad range of factual alternatives. Some of the alternatives might, in conjunction with other facts not presently alleged by the appellants, give rise to a claim for subordination. Others are totally innocuous.

If discovery had been completed and the cases were ready for trial, the Court might be able to speculate, with some hope of success, as to the pertinent facts. But even the present pleadings do not place definite limitations upon the pertinent facts which the parties may wish to prove because the future amendment of the pleadings is a likely possibility.

Hence, any guidelines which the Court might wish to hand down at the present time would be of doubtful value and might actually impede the administration of justice. Suppose, for example, that the Court set forth an order of priority which omitted any reference to facts that a party offered to prove at trial. The District Court would then be faced with the question of whether the facts which the proffered evidence were to prove had been considered by this Court and rejected as immaterial, or whether it had merely failed to anticipate the facts. The risk of introducing an undesirable rigidity into the litigation is apparent.[16]

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[16]An appellate Court, presented with appeals at the pleading stage, might well be cautious in assuming that the Telephone Company anticipated no "benefits" except the prevailing interest rate in placing $500,000 in SFNB (see opp. cit. fn. 3, *supra*), and that a Bay Area financial institution which recites in its brief, filed more than two years after SFNB's seizure, that "Security has not submitted its claim to and therefore has not received from the Federal Deposit Insurance Corporation the $10,000.00 insurance proceeds to which it is entitled" (Open. Br. Appellant Security Savings and Loan Association, p. 2, item 2) has fully disclosed the extent of its involvement with SFNB. A "benefit", understood by the Majority Depositor to be compensation, from the borrower or broker in link financing, as above discussed, for the *making* of the deposit, if that is what the Telephone Company and Security are charging against St. Joseph's Church and the other 80-plus depositor-defendants, is, by contrast, an understandable motivation to placing a deposit in a distant bank.

Conclusion.

In any event should the Court decide to set forth guidelines for the determination of priorities, notwithstanding the considerations discussed herein, those guidelines should not be formulated until the related appeals have been heard. The guidelines will necessarily affect the claims asserted in the related appeals and elementary considerations of fairness require that the parties thereto be given the opportunity to be heard on a matter which will substantially, and perhaps irrevocably, affect their rights.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

AARON M. PECK

APPENDIX "A".

Appellees	Amount of Deposit*
A.M.R. Inc.	$ 40,000.00
Alamo Savings & Loan, San Antonio, Texas	50,000.00
Altadena Federal Savings & Loan, Altadena, California	110,000.00
American Federal Savings & Loan, Fort Wayne, Indiana	20,000.00
Broadway Equities, Inc., New York, New York	10,000.00
Burrough Detroit Employees Credit Union, Detroit, Michigan	50,000.00
Charter Savings & Loan, Bellflower, California	10,000.00
Coachella Valley Savings & Loan, Palm Springs, California	600,000.00
Columbia Savings & Loan, San Fernando, California	100,000.00
Community Federal Savings & Loan, Riviera Beach, Florida	10,000.00
Corning Glass Works Employees Federal Credit Union	10,000.00
Custer County Federal Savings & Loan, Weatherford, Oklahoma	10,000.00
Dearborn Schools Credit Union, Dearborn, Michigan	10,000.00
Designing Engineers Credit Union, Dearborn, Michigan	25,000.00
Detroit Teachers Credit Union, Detroit, Michigan	50,000.00
First Federal Savings & Loan, Arkansas City, Kansas	50,000.00
First Federal Savings and Loan Association of Manatee County	100,000.00
First State Bank, Bangs, Texas	10,000.00
First Western Savings & Loan, Las Vegas, Nevada	500,000.00
Flagler Federal Savings & Loan, Miami, Florida	200,000.00
Flint Teachers Credit Union, Flint, Michigan	20,000.00

*The amount listed is principal only. In each instance interest is also due. Each deposit has been reduced, since the filing of the action below, by payment by the FDIC of $10,000. deposit insurance, giving the FDIC the right of subrogation to such amount. Such deposit insurance payments have been accepted without prejudice to the claim of constructive trust and priority over the FDIC for the unpaid amounts.

Appellees	Amount of Deposit
Friendship Federal Savings & Loan, Pittsburgh, Pennsylvania	100,000.00
Glendale Federal Savings & Loan, Glendale, California	1,500,000.00
Hawthorne Savings & Loan, Hawthorne, California	100,000.00
Home Federal Savings & Loan of East Rochester, Rochester, New York	100,000.00
Home Federal Savings & Loan of San Diego, San Diego, California	750,000.00
Home Savings Association, Chanute, Kansas	20,000.00
International Union, United Automobile, Aerospace and Agricultural Implement Workers of American—UAW	3,000,000.00
Jervis Corp. Employees Credit Union, Grandville, Michigan	10,000.00
Kawneer Employees Credit Union, Niles, Michigan	10,000.00
Lawrence-Cedarhurst Savings & Loan, Cedarhurst, L.I., New York	200,000.00
Library Credit Union, Detroit, Michigan	10,000.00
Marina Federal Savings & Loan, Los Angeles, California	10,000.00
Mile High Savings & Loan, Denver, Colorado	70,000.00
Monarch Savings & Loan, Los Angeles, California	10,000.00
Nevada Savings & Loan, Las Vegas, Nevada	200,000.00
North American Investment Fund, NV	50,000.00
Redwood Empire Savings & Loan, Petaluma, California	300,000.00
Rock Falls Savings & Loan, Rock Falls, Illinois	10,000.00
Shaker Savings & Loan, Shaker Heights, Ohio	350,000.00
South Ferry Building Co., New York, New York	10,000.00
Union Federal Savings & Loan, Pittsfield, Massachusetts	100,000.00
Voice of Music Employees Credit Union	10,000.00
Victoria Savings & Loan, Riverside, California	150,000.00
Westdale Savings & Loan, Los Angeles, California	50,000.00
Western Savings and Loan Association (successor to Home Savings and Loan Association of Phoenix, Arizona)	630,000.00